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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 486.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

METROPOLITAN EDISON COMPANY, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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IN THE

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OCTOBER TERM, 1938. No. 486.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

v.

Metropolitan Edison Company,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals in the *Metropolitan Edison Company* case (R. 29-44), is reported in 35 B. T. A. 1110, and that of the Circuit Court of Appeals (R. 50-55) is reported in 93 F. (2d) 807.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered August 23, 1938 (*Metropolitan Edison Company case,* R. 55). At the same time the Circuit Court of Appeals entered judgment in the case of the *Pennsylvania Water and Power Company* v. *Commissioner,* 98 F. (2d) 812. A single petition for writs of certiorari in the two cases was filed November 23, 1938, and was granted January 3, 1939. (*Metropolitan Edison Company case* No. 486, R. 55, *Pennsylvania Water and Power Company case* No. 487, R. 48.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

1. The taxpayer, a Pennsylvania corporation, acquired all of the assets of its wholly owned subsidiary in consideration of the delivery to the subsidiary of all of the subsidiary's capital stock and the assumption by the taxpayer of all of the subsidiary's indebtedness. This transaction was carried out in accordance with Sec. 23 of the Act of 1874, as amended, Section 595, Title 15, Purdon's Pennsylvania Statutes, *infra.* The taxpayer, the parent company, retired bonds issued at a discount by its former subsidiary. Is the taxpayer entitled to deduct from its gross income the unamortized bond discount and expense in the year of the retirement of the bonds?

2. The facts are the same as in Question 1, except that the transaction was not carried out under any Pennsylvania statute and the subsidiary was not immediately dissolved. Is the taxpayer entitled to deduct the unamortized bond discount and expense in the year of the retirement of the bonds?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendices A and B, *infra,* pp. 69, 73.

STATEMENT OF THE CASE.

This brief is being filed only on behalf of the Metropolitan Edison Company, Respondent in case No. 486, and the facts pertaining thereto are as set forth in the Petitioner's Brief, pp. 3-8.

SUMMARY OF ARGUMENT.

The general rule is that a corporation which issues bonds at a discount may deduct amortization of the bond discount and expense. It is also well established that where there has been a merger or consolidation which makes the transferee liable by operation of law for the debts of the transferor and which continues the existence of the transferor within the transferee the merged company may deduct unamortized bond discount and expense remaining on bonds issued by

the predecessor, proportionately in each year and any balance remaining in the year in which the bonds are retired prior to maturity may be deducted as a loss.

In 1928 the Metropolitan Edison Company assumed, before maturity, certain bonds which had been issued at a discount by other corporations whose assets it had acquired and whose liabilities it had assumed pursuant to Section 23 of the Pennsylvania Act of 1874, as amended, Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 73).

The transactions in this case carried out in accordance with the provisions of the Act of 1874 as amended, were, under Pennsylvania law, strict mergers since the predecessor corporations ceased to exist and the successor corporation became liable for their debts and obligations by operation of law. The court below found this to be the law of Pennsylvania and permitted the Metropolitan Edison Company to deduct the unamortized portion of the bond discount and expense remaining at the time that the bonds of the predecessor corporations were redeemed prior to maturity. The decision of the court below in so holding was correct, and the decision of the Circuit Court of Appeals for the Second Circuit in the case of *General Gas and Elec. Corp.* v. *Commissioner of Internal Revenue,* 98 F. (2d) 561 (now pending before the Court, Nos. 492-493, present term), in holding to the contrary, was erroneous.

In 1927 the Metropolitan Edison Company likewise redeemed, prior to maturity, bonds issued by

another subsidiary whose assets it had acquired. Even though that transfer was not carried out pursuant to the provisions of the Act of 1874, as amended, there was, nevertheless, under Pennsylvania law a *de facto* merger warranting the allowance of the deduction of the unamortized bond discount and expense with respect to those bonds.

Regardless of whether or not the transactions in this case constituted strict or *de facto* mergers, the taxpayer is, nevertheless, entitled to the deductions claimed since it was the taxpayer which actually sustained the loss in redeeming the bonds prior to maturity. Such loss was not compensated for either directly or indirectly since the taxpayer, in taking over the subsidiary companies, gave nothing in exchange for the assets acquired, by way of consideration or otherwise, which reflected or made allowance for the prospective loss which the taxpayer would sustain in redeeming the bonds prior to maturity. Furthermore, this is not a case in which one corporation is attempting to carry over or avail itself of a loss actually sustained by a predecessor corporation. No loss on account of unamortized bond discount and expense was sustained at all until the taxpayer redeemed the bonds of the predecessor companies whose assets and liabilities it had carried over and assumed.

The attempt of the petitioner to limit the allowance of such deductions to cases where there has been a statutory merger ignores the legislative intent that in computing its net taxable income a corporation

may deduct a loss which it has sustained and for which it has not been compensated. By taking over the assets and assuming the liabilities of the predecessor corporations in the manner involved in this case, the taxpayer acquired assets which represented the proceeds of the sale of the bonds and against which there remained unamortized bond discount and expense for which no compensating adjustment was or could have been made to the taxpayer, as the transactions were essentially mergers and not sales. Since the taxpayer and the taxpayer alone, actually sustained a loss when the bonds were redeemed prior to maturity, it is entitled to take the deductions claimed.

ARGUMENT.

I.

The Transactions by Which the Metropolitan Edison Company Took Over the Assets and Assumed the Liabilities of Certain Subsidiaries Pursuant to Section 595, Title 15 of Purdon's Pennsylvania Statutes Were True Mergers and Hence Come Within the Established Rule That a Corporation Succeeding Through Merger to the Assets and Liabilities of Another May Deduct Amortization of Bond Discount and Expense With Respect to Bonds Issued by a Predecessor.

In 1928, the Metropolitan Edison Company retired at a premium before maturity, certain bonds issued

y certain of its subsidiaries whose assets it took over nd whose liabilities it assumed pursuant to the provisions of Section 23 of the Act of 1874, as amended, Section 595, Title 15 of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 73). The subsidiary companies involved were the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company. The total amount of the unamortized bond discount and expense on the bonds issued by these companies amounted to $752,481.26 (R. 34). The court below allowed the Metropolitan Edison Company to deduct the discount and expense applicable to the bonds which had not been amortized up to the time of their retirement.

The Petitioner, on pages 19 and 20 of his brief, admits that when there has been a true merger or consolidation so that the life of the corporation issuing the bonds continues in the successor and the successor becomes liable for the debts of the issuing corporation by operation of law, the successor is allowed to deduct amortization of discount and expense with respect to bonds issued by the predecessor, and unamortized discount and expense on any such bonds which are retired prior to maturity, citing the *American Gas & Elec. Co.* v. *Commissioner*, 85 F. (2d) 527 (C. C. A. 2d); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.); *New York Cent. R. Co.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner*, 33 F.

(2d) 695 (C. C. A. 4th). See also *Illinois Power & Light Corp.* v. *Commissioner,* 33 B. T. A. 1189; *Connecticut Electric Co.* v. *Commissioner,* 35 B. T. A. 444.

The Respondent here contends that it should be allowed the deduction under the above stated rule for the reason that the transactions by which the Metropolitan Edison Company took over the assets and assumed the liabilities of its subsidiaries pursuant to the provisions of Section 23 of the Act of 1874, as amended, Section 595, Title 15, of Purdon's Pennsylvania Statutes, *infra,* had all of the essential elements of a true merger in that, under Pennsylvania law, the subsidiaries ceased to exist by operation of law and the taxpayer continued to exist thereafter and became liable for the debts of the absorbed corporations both under contract and by operation of law. In this contention the Respondent was sustained by the court below which likewise applied the same reasoning in the case of the *Pennsylvania Water & Power Company.*

As has been pointed out by the Petitioner in his brief, on substantially the identical facts the Circuit Court of Appeals for the Second Circuit held in the case of *General Gas and Electric Corp.* v. *Commissioner,* 98 F. (2d) 561 (C. C. A. 2nd), that the transactions carried out pursuant to Section 595 did not effect a true merger and hence that the deductions were not allowable.

Both the Circuit Court of Appeals for the Third Circuit and the Circuit Court of Appeals for the

Second Circuit stated that the question was to be determined under the laws of Pennsylvania.

When the Metropolitan Edison Company absorbed its subsidiary companies, two forms of transactions were authorized under the laws of Pennsylvania by which the assets and franchises of one corporation might be taken over by another. One course of procedure, sometimes referred to in the Pennsylvania cases as the "long form merger," was provided for by the Act of May 3, 1909, Title 15, Purdon's Pennsylvania Statutes, Section 421, *et seq.* (Appendix B, *infra,* p. 74). The other form of procedure, sometimes referred to in the Pennsylvania cases as the "short form merger," was provided for by Section 23 of the Act of April 29, 1874, as amended, Title 15, Purdon's Pennsylvania Statutes, Section 595 (Appendix B, *infra,* p. 73).

The "short form merger" provided for by the Act of April 29, 1874, as amended, was followed in the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company. Section 23 of the Statute provides in part that any corporation, with the consent of its stockholders, is entitled:

> "* * * to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this Act, its franchises and all of its property, real, personal and mixed and that thereafter such corporation shall cease to exist

and that the said property and franchises not inconsistent with this Act shall thereafter be vested in the corporation so purchasing as aforesaid. * * *."

The Circuit Court of Appeals for the Second Circuit in its opinion in the case of *General Gas & Electric Corp., supra,* sustained the contention of the Commissioner of Internal Revenue that in the years in question a technical merger could only be effected by complying with the provisions of the Act of May 3, 1909, for the reason that the provisions of that Act alone imposed liability by operation of law upon the successor corporation for the debts and liabilities of the absorbed corporation. Moreover, the Circuit Court of Appeals for the Second Circuit found that a transaction consummated in accordance with the provisions of the Act of 1874, as amended, constituted a sale and that the successor corporation did not succeed by operation of law to the debts and liabilities of the predecessor corporation. With this holding the Respondent cannot agree since it is believed that the same is not a correct interpretation of the law of Pennsylvania, and that the court below properly found that a transaction consummated in accordance with the provisions of the Act of 1874, as amended, did constitute a true merger.

A discussion of the proper construction to be placed upon provisions of Section 23 of the Act of 1874 logically divides itself into several parts.

1. General Definition of the Term "Merger."

In order to determine whether or not the transactions by which the Metropolitan Edison Company acquired the assets and liabilities of the two affiliated companies was a merger, it will be helpful to define the term as used by the courts.

There is a definite distinction between a "consolidation," "merger" and "sale" although the same has not always been observed by the legislatures in drafting statutes or by the courts in writing opinions. This fact has resulted in considerable confusion.

A "*consolidation*" is a combination of two or more corporations by which the property, rights and privileges and franchises of all the consolidating corporations are united in a single new corporation, the consolidating corporations losing their separate corporate identities. 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7041, pp. 6-8.

A "*merger*" is the absorption of one or more corporations by another, the former ceasing to exist and the latter retaining its corporate identity with the added capital, franchises and powers of the merged corporation or corporations. "It is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein." 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7041, pp. 7-8.

A "*sale*" is a transfer of property for a consideration, both the buying and selling corporations retain-

ing their corporate existence. "Where there is a mere sale or transfer of the assets to another corporation a new corporation is not created, and the respective companies still remain distinct legal entities." 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7044, p. 16.

B. PENNSYLVANIA CASES HOLD THAT A MERGER MAY BE ACCOMPLISHED UNDER THE PROVISIONS OF SECTION 23 OF THE ACT OF 1874, AS AMENDED.

Bearing in mind the distinction between a "merger," a "consolidation" and a "sale," let us proceed to an analysis of the Pennsylvania statutes and the decisions interpreting the same.

The Act of May 3, 1909, does not provide for a "*merger*" at all and only provides for a "*consolidation.*" It provides that a joint agreement shall be entered into, setting forth the "name of the *new* corporation," * * * "the *first* directors and officers," * * * "the manner of *converting the capital stock of each of said corporations into the stock of the new corporation,*" and that "new letters patent" shall be issued thereon. It is clear, therefore, that although the Act of 1909 uses the terms "merger and consolidation" it effects a combination of two or more corporations into a single *new corporation* for which new letters patent must be issued and the stock of which must be substituted for the stock of the old corporations. Since the Act creates a *new corporation* in place of all the old corporations com-

oined thereunder and does not provide for the *urvival of one of the old corporations* with the dded franchises, powers and property of the others, t is clear that this is a *"consolidation"* statute and ot a *"merger"* statute.

The Act of April 29, 1874, as amended definitely provides a procedure by which the property, rights and franchises of one corporation may be united with those of another, the latter continuing its existence while the former, by operation of the statute, ceases to exist.

The Act of 1909 and the Act of 1874, as amended, were both repealed by enactment of the new Corporation Law of 1933 which substituted therefor new statutory provisions for mergers and consolidations clearly distinguishing between the two.

In *Pennsylvania Corporation Laws of 1933,* the following annotation by E. Russell Stockley, Esquire, Special Deputy Attorney General and draftsman of the Act of 1933, appears on page 104 as a note to Sec. 901:

> "As used in the Act of 1909, the words 'consolidate' and 'merge' were used synonymously, whereas such works technically, have different meanings. In a merger, only one of the constituent corporations survives whereas the others lose their identities; while in a consolidation all the constituents lose their identities and a new corporation springs up in their place. This Act, (referring to the 1933 Act) like the Uniform Act and the Acts of the states above listed, makes a

clear distinction between a merger and a consolidation."

Mr. Stockley again in the last two sentences of his last two "comments" Section 311 of the *Pennsylvania Corporation Laws of 1933,* page 39 says:

> "* * * This provision of the Act provides a statutory procedure for the voluntary sale of the corporation property and assets, executing its franchises, and makes no change in the existing law. *It does not, however, authorize or have the effect of a merger similar to that formerly authorized by Section 23 of the Corporation Act of 1874 as amended."* (Italics added.)

As has been pointed out, the Act of 1874, as amended, was the only law of Pennsylvania under which a merger could be effected prior to the new Corporation Law of 1933. If the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company had taken the place after the Corporation Act of 1933 became effective and the merger had been consummated under the provision of Article IX thereof, there would be no question but that the transactions were statutory mergers. The transactions by which the Metropolitan Edison Company absorbed its four affiliates in question, however, took place in accordance with the Act of 1874, as amended. The result of such a transaction has been

peatedly held by the courts of Pennsylvania to be "merger."

In *Bly* v. *White Deer Mountain Water Co.*, 197 a. 80, the Supreme Court of Pennsylvania held at certain utility corporations could carry on their usiness only in the town, borough, city or district which they were located and not in territory djacent thereto. The practical result of this decision as that it became necessary for some utility companies to form a different corporation in other unicipal districts where present or future operaons might be contemplated. It being important to onstruct a separate operating plant in each district or which a charter had been granted, a plan was evolved to unify the corporations so that the business ould be carried on in substantially the same manner s if the charter of one corporation authorized it o operate in all the districts. The Legislature had rescribed two methods by which such unification ight be effected: (1) merger under the Act of pril 29, 1874, as amended or (2) consolidation nder the Act of 1909.

As the effect of the Act of 1874, as amended, was to reserve the identity or existence of one corporation offered certain advantages over the creation of a ew corporation under the Consolidation Act of 1909, nd was therefore largely employed. The two methods ecame distinguished by the respective descriptive, ut untechnical names of "short form" and "long orm" merger.

In *Pennsylvania Utilities Co.* v. *Public Service Commission,* 69 Pa. Sup. Ct. Rep. 612, Judge Kephart, now Chief Justice of the Supreme Court of Pennsylvania, made the following statement concerning the necessity of unifying the charters of such utility companies and recognized the fact that the merger resulting under the Act of 1874, as amended (which he called the Purchase Act of 1876, presumably because one of the steps in effecting the merger took the form of a sale) p. 614:

> "The question presented by this and a number of other appeals now before the court is of considerable importance to utility companies in the Commonwealth. After the decision in the case of Bly *v.* White Deer Mt. Water Company, 197 Pa. 80, there was a great effort by certain utilities to secure charters for the municipal districts they deemed necessary to their present and future plan of development. These concerns found it impossible, because of their great economic waste, to construct separate operating plants in each of the districts for which charters were secured. The legislature had supplied a way by which the charters might be unified and very much the same result obtained as though a charter for more than one district had been permitted. The Purchase Act of 1876 was largely employed. See Hey *v.* Springfield Water Co., 207 Pa. 38; Commonwealth *v.* Lumber City Water Co., 225 Pa. 317; Greensburg Boro. *v.* Westmoreland Water Co., 240 Pa. 485; and a list of authorities there referred to. *As a legal consequence the purchase act differs but little from the merger act which is used to some extent to consolidate companies.*" (Italics added.)

In *York Haven Water and Power Company et al.* v. *Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419, the question before the Court concerned the right of an electric light, heat, and power company to merge with an hydro-electric or water power company. The Court held that the merger could not be accomplished until the right of the hydro-electric company to furnish water to the public (which was not common to both companies) was legally discarded and in the course of the opinion Kephart, *J.*, said:

> "There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the Act of 1876, as amended, and the Act of 1909. The Act of 1876, P. L. 33, as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the merger Act of 1909, P. L. 408, permits consolidation between corporations 'transacting the same or similar lines of business.' * * * A sale or merger, under the Act of 1876, with its amendment, or the Act of 1909, which is practically the same, cannot take place until the company legally discards the offending power."

The Act of 1876 mentioned by the Court is the Act of 1874, as amended by the Act of April 17, 1876, Section 5 and the Act of June 2, 1915, under which the transactions in the case at Bar were effected.

The language used by Judge Kephart in *Pennsylvania Utilities Company* v. *Public Service Commission, supra,* illustrates the confusion in the use of

terms to which the courts fall prey, but indicates the recognition by the Supreme Court of Pennsylvania that transactions effected under the Act of 1874, as amended, and under the Act of 1909 are "practically the same."

In the latest utterance of the Supreme Court of Pennsylvania (*Northern Pennsylvania Power Co. and Metropolitan Edison Co.* v. *The Pennsylvania Public Utility Commission,* filed January 26, 1939, not yet reported), Mr. Justice Schaffer said, in referring to proceedings under the Act of 1874 as amended:

> "The Pennsylvania Public Utility Commission refused to allow the Northern Pennsylvania Power Company to sell its franchise and all the property owned by it, to Metropolitan Edison Company, and *thereby to bring about a merger of the former with the latter.* * * * *We are of opinion that the sale and consequent merger* will not adversely affect the public interest, and the action of the Commission in refusing its approval thereof was arbitrary and unreasonable." (Italics added.)

As the above discussion shows, the Pennsylvania cases have held that the Act of 1874, as amended, is a merger statute and that transactions consummated thereunder are known in Pennsylvania as "short form mergers" as distinguished from "long form mergers" effected under the provisions of the Act of 1909.

Not only have the Pennsylvania courts recognized that the Act of 1874, as amended, is a merger statute, but transfers accomplished in accordance with the

provisions of that Act meet all of the tests of a strict merger as set forth in the case of the *American Gas and Electric Co.* v. *Commissioner,* 85 F. (2d) 527 C. C. A. 2, where the Circuit Court of Appeals for the Second Circuit stated as an essential of such a merger as would entitle the successor corporation to claim deductions of the unamortized bond discount and expense of the merged corporation, that the merged corporation shall cease to exist and that the successor corporation must, by operation of law, become responsible for the liabilities of the merged corporation.

C. A TRANSACTION CONSUMMATED UNDER THE ACT OF 1874, AS AMENDED, IS A MERGER AND NOT A SALE SINCE THE TRANSFEROR CORPORATION CEASES TO EXIST.

Section 23 of the Act of 1874, as amended specifically provides that a corporation which sells, assigns, or conveys to another corporation its franchises and property shall thereafter "*cease to exist* and * * * the said property and franchises not inconsistent with this Act shall therefore be vested in the corporation so purchasing as aforesaid * * *."

In this connection the court below in this case, at page 810 of the Reports said:

> "Both the short and long form statute are equally explicit in providing that the absorbed corporation ceases to exist. It would, therefore, appear that the effect of a merger under both statutes is the same in this respect."

In contending that the transactions in question were sales the Petitioner relies upon the following

statement of Kephart, *J.*, in *In Re Buist's Estate*, 297 Pa. 537, 147 Atl. 606:

> "Care should be taken to distinguish consolidations from proceedings under the Act of 1876, P. L. 33, often referred to as a 'short form merger' (See York Haven W. & P. Co. v. Pub. Ser. Com., 287 Pa. 241); its operation in reality effects a sale of all the company's assets."

The question before the Court in the above case involved the rights of a life tenant, receiving the income from a trust, to certain stock received by the trust upon the merger of a number of banking institutions into the Philadelphia National Bank under the Act of Congress empowering national banks to consolidate. All that Kephart, *J.*, intended to point out in that portion of his opinion above quoted was that the Act of 1876, amending the Act of 1874, did not provide for consolidations but only for mergers which were effected through a transfer by one corporation to another of "its franchises and all its property, real, personal and mixed,"—the transaction taking the form of a sale, thereby distinguishing such a transaction from a consolidation of national banks under the Act of Congress which is not accomplished through the form of a sale. The observation made by Kephart, *J.*, with reference to the Act of 1874, as amended, should not be taken as a holding by the Supreme Court of Pennsylvania that the Act does not effect a merger but only that a transaction under the Act effects a merger by employing as one of the steps a form of "sale."

In 8 *Thompson on Corporations,* Third Edition, Section 6012, page 66, the learned author says:

> "* * * In a merger of two or more corporations, one of the merged corporations survives; that is, the merger consists in the uniting of two or more by the transfer of all the property to some one of the existing corporations, which continues its existence, while the others are swallowed up by or merged in the one that exists. And in this respect it differs from a consolidation, wherein * * * all the corporations terminate their existence and become parties to a new one. *The true test as to whether or not there has been a merger, is as to whether the existence of one of the corporations has been preserved and the other has ceased to exist.*" (Italics added.)

In Section 6019, at page 78, the author further says:

> "* * * But, as already noticed, and as judicially held, consolidation may be effected by the purchase of all the property and franchises of one corporation by another * * *"

In 15 *Fletcher Cyclopedia Corporations* (permanent edition), Section 7044, pp. 16-17, the author says:

> "* * * if the coming together of two corporations under the authority of law be in fact consolidation * * * it is of no consequence by what name the act is characterized nor is it of any consequence by what steps the result has been effected, *and one of those steps may take the shape of bargain and sale.*" (Italics added.)

If it is borne in mind that a merger may be accomplished in the form of a bargain and sale, a great deal of the confusing language in the cases

is explained. It is submitted that the contention of the Petitioner and the decision of the Circuit Court of Appeals for the Second Circuit in the *General Gas & Elec. Corp.* case are based upon the failure to observe this fact. It is true that under the Pennsylvania "short form" merger, one step takes the form of a sale. The important point to note, however, is that the "sale" under the Pennsylvania Law is merely a means of effecting the merger of corporations. That this fact is important is shown by the case of *Bassick* v. *Commissioner of Internal Revenue*, 85 Fed. (2d) 8 (C. C. A. 2) (certiorari denied 299 U. S. 592), where the Court said: "For Income Tax purposes, the component steps of a single transaction cannot be treated separately."

In *Chicago Santa Fe and California Railway Co.* v. *Ashling*, 160 Ill. 373, 380, 381, 43 N. E. 373-375, the Chicago and St. Louis Railway Co. transferred all of its properties and franchises by deed of conveyance to the appellant. The question before the Court was whether this transaction which was in the form of a sale was not in fact a "consolidation." In holding that the transaction was a "consolidation" and that the defendant was liable for the torts of its predecessor from which it purported to "buy" assets, the Court said:

> "* * * It is true, that what was done must be considered in order to determine whether there was a consolidation or not; but we must look to the results accomplished, rather than to the means, steps or procedure by which those results have been attained.

"* * * *There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation.* It cannot be supposed, from the nature of this transaction, that it was expected that the St. Louis Company should continue its active corporate existence after divesting itself of all its property, corporate rights and franchises and stockholders." (Italics added.)

In *Continental Trust Company* v. *Toledo St. L. & K. C. R. Co.*, 82 Fed. 642, 652, Mr. Chief Justice Taft, then Circuit Judge, considered the effect of an Illinois Statute which provided:

"That all railroad companies now organized, or hereafter to be organized under the laws of this state, which now or hereafter may be, in possession of and operating in connection with or extension of their own railway lines any other railroad or railroads in this state, or in any other state or states, or owning and operating a railroad which connects at the boundary line of this state with a railroad in another state, *are hereby authorized and empowered to purchase and hold in fee simple* or otherwise and to use and enjoy, the railway property, corporate rights and franchises of the company or companies owning such other road or roads upon such terms and conditions as may be agreed upon between the directors and approved by the stockholders," etc. (Italics added.)

Concerning the effect of this statute the learned Judge said:

"Although this act uses the word 'purchase,' it plainly contemplates consolidation, and this is the holding in Illinois * * *."

The authorities clearly support the proposition that either a merger or consolidation may be accomplished even though one of the steps in effecting the merger may be a sale. The true test in determining whether or not a certain transaction between two or more corporations constitutes a merger is whether the existence of one of the corporations has been preserved and the others have been swallowed up by or merged in the one that continues in existence.

The "short form" merger under Pennsylvania law meets all the essential legal requirements of a merger, which was defined by Judge Augustus N. Hand in *Cortland Specialty Co. et al.* v. *Commissioner of Internal Revenue,* 60 F. (2nd) 937 (1932) (Cert. Den. 288 U. S. 599, 77 L. Ed. 975), as follows:

"Reorganization, merger, and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. * * * *A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives.* A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. * * * A sale of the assets of one corporation to another for cash without the retention of any interest

by the seller in the purchaser is quite outside the objects of merger and consolidation statutes." (Italics added.)

Following the completion of the transfer by the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company of all of their assets to the Metropolitan Edison Company in accordance with the provisions of the Act of 1874, as amended, the transferor corporations in the case at bar, in accordance with the express provisions of the statute, ceased to exist and were, in fact, dissolved. Of course, as in all cases of merger or consolidation of corporations, the absorbed corporation continues to exist for the purpose of actions pending against it. The court in *Merwine* v. *Mt. Pocono Light & Improvement Co.*, 304 Pa. 517, 156 A. 150 (which will be discussed in greater detail hereafter), in stating that a corporation which has merged pursuant to the provisions of Section 23 of the Act of 1874 continues its independent existence could only have meant that it does so for the purpose of actions pending against it. This is true of all corporations in Pennsylvania whether merged under the "long form merger" statute or under the "short form merger" statute. Each statute expressly provides that the merged corporation shall cease to exist as an independent entity.

In the case of *Petry* v. *Harwood Electric Co.*, 280 Pa. 142, the Supreme Court of Pennsylvania had

before it the question of the effect of a merger and said at page 146:

> "That, in the domain of the practical, a dissolution resulted from the merger there can be no doubt; after it was accomplished the defendant's existence ended, so far as being a going, operating entity is concerned; its property and good will passed into the control and ownership of the new corporation and it ceased to do business. The effect was to wipe out the merging companies and fuse them all into the new one created.
>
> "It is argued by appellant that a dissolution did not take place, because what resulted has none of the attributes of a dissolution, as there was no liquidation and winding up of the company, no sale, no fund raised, no payment of indebtedness and no surplus for distribution among stockholders, that even the separate existence of the company was not terminated, since the merger statute provides that the constituent companies may be deemed 'to be in existence' to preserve the rights of creditors and liens upon the property."

The court, however, came to the conclusion that the transaction constituted a merger and it is therefore clear from this decision that even though a constituent company in a merger may be deemed "to be in existence" to preserve the rights of creditors, the effect of the merger for all other purposes is to wipe out the merging company and fuse it into the new one.

Since under the Pennsylvania law the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company

ceased to exist as independent entities when they were absorbed by the Metropolitan Edison Company under the Act of 1874, as amended, the transaction in each case was a merger and not a sale, and the existence of the merged companies was carried forward and continued in the successor corporation.

D. As a Result of a Merger Effected Under the Provisions of the Act of 1874, as Amended, a Transferee Corporation Succeeds by Operation of Law to the Liabilities of the Transferor Corporation.

In its opinion in the *General Gas & Elec. Corp.* case, *supra,* the Circuit Court of Appeals for the Second Circuit in coming to the conclusion that the Pennsylvania "short form merger" constitutes a sale and that creditors of the transferor can hold the transferee liable only on principles of fraudulent conveyance and to the extent of the value of assets received, relies upon the case of *Merwine* v. *Mt. Pocono Light & Improvement Co.,* 304 Pa. 517, 156 A. 150.

In that case the appellant had sued to recover damages for personal injuries. The defendant's attorney filed a suggestion setting forth that the property and franchises of the defendant had been conveyed to the Pennsylvania Power and Light Co. in *proceedings under the Act of 1874, as amended;* they alleged that under the Act the defendant had ceased to exist and therefore prayed that the action against it should be abated. Plaintiff filed an Answer and prayed that

a Rule be allowed to show cause why the Pennsylvania Power and Light Company should not be substituted as defendant. The Court below denied the prayer of the plaintiff and abated the action.

On appeal, the Supreme Court of Pennsylvania held that termination of the corporate existence of the defendant company under the Act of 1874, as amended, did not abate the action.

Counsel for the appellant had contended in his brief (page 518 of Opinion) that "The transaction was a merger, not a sale." In considering this contention the Court said at pages 524-525:

> "Although we need not decide the point, it is proper to call attention to the fact that the pleadings indicate that the Pennsylvania Power & Light Company took over the property of defendant under circumstances warranting a finding, upon evidence produced to support the allegations in the pleadings, *that the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume defendant's obligations.* There is much to show that the purchase was attended by an intimacy of interest tending to render the transaction, in so far as the Pennsylvania Power & Light Company's interest was concerned, a purchase *cum onere.* For instance, it is averred that, at the time of the commission of the alleged negligent acts on the part of the Mount Pocono Light & Improvement Company, it was affiliated or associated with the Pennsylvania Power & Light

Company to the extent that both companies were managed, operated and controlled under the same management and system. It is admitted that the common stock of both companies was owned by the same holding company, and, by defendant's own showing, thirteen of the same persons were officers or directors in both companies. It further appears that both companies operated from the same office. Plaintiff states that the business of the Mount Pocono Company was conducted by the agents, servants and employees of the Pennsylvania Power & Light Company; that after the sale, the power company took over and operated the business formerly conducted by defendant; and that the sale was merely a formality giving effect to a union of the companies which had in reality occurred previous to the accident upon which the suit is based." (Italics added.)

Attention is particularly called to that portion of the above statement appearing in italics whereby the court definitely states that a transfer by a corporation (under the procedure prescribed under the Act of 1874, as amended) of its franchises and property to "the buying corporation," with which it is affiliated, is simply a formality and the transfer in reality is a merger of the two companies. All that the Court actually held in the *Merwine* case was that the action brought against the merged subsidiary prior to the merger did not abate, and that if the plaintiff recovered judgment against the Mt. Pocono Company she could "levy where defendant's assets liable for the judgment may be found."

The Circuit Court of Appeals for the Second Circuit stated in its opinion in the *General Gas & Elec. Corp.* case, *supra,* that the transfer of the property of the Mt. Pocono Company to the successor corporation might be set aside as being in fraud of creditors and in that sense only did the successor corporation succeed to the liabilities of the absorbed corporation. This, however, is not the procedure under the law of Pennsylvania.

A Pennsylvania corporation which has acquired the assets of another corporation in accordance with the provisions of the Act of 1874 as amended, succeeds to the liabilities of the transferor, not by reason of any application of the doctrine of fraudulent conveyances, but by reason of the fact that in Pennsylvania such liability is, by operation of law, an inherent part or consequence of a merger.

The Statute of 13 Elizabeth, Chapter 5, dealing with fraudulent conveyance applies to colorable sales made for the purpose of delaying or hindering creditors and it declares such sales to be "utterly void." This Statute has no bearing on mergers or consolidations which are authorized by statute. The transaction in the *Merwine* case and in the case at bar were specifically authorized by the Act of 1874. Section 23, as amended and are therefore lawful and not "utterly void" under the Statute of Elizabeth.

The Statute of Elizabeth may apply to ordinary sales of corporate property such as those referred to in the following cases cited by Petitioner in his brief:

Ringler v. *Atlas Portland Cement Co.*, 301 Pa. 176, 151 A. 815;
Mount Union Borough v. *Kunz*, 290 Pa. 356, 139 A. 118;
Maxler v. *Freeport Bank*, 275 Pa. 510, 119 A. 592;
Koehler v. *St. Mary's Brewing Co.*, 228 Pa. 648, 77 A. 1016;
Carr v. *Rochester Tumbler Co.*, 207 Pa. 392, 56 A. 945.

In *Montgomery-Web Company* v. *Dienelt*, 133 Pa. 585, 19 A. 428, the Court held an ordinary sale of property by a corporation to be void, just as "in the case of an individual, a transfer to his wife or his agent, or anybody who should merely represent himself under another name, would be unquestionably void against creditors."

In cases of ordinary sales in fraud of creditors the creditors may (*a*) pursue the assets in the hands of the new company through judgment against the old company on theory that the sale is void or voidable, or (*b*) by proper proceedings fasten a constructive trust as to such assets on the new company as Trustee (*Halpern* v. *Grabosky*, 296 Pa. 108, p. 112, 145 A. 834), or (*c*) file a bill in equity to discover assets and impose liability upon the theory that equity regards the property as a trust for the payment of existing debts, and will follow it on behalf of creditors until it gets into the hands of innocent purchasers for value (*Montgomery-Web Company* v. *Dienelt*, 133 Pa. 585, p. 596, and *Mt. Union Borough* v. *Kunz*, 290 Pa. 356, p. 362).

In the latter case while the transfer of the water works was made under the Act of 1874, Section 23, as amended, the transaction was an *ordinary sale,* not a *merger,* as the purchase price was $60,000 in cash and other considerations. There was no amalgamation of interests, as there must be in a merger; the old owners did not divorce themselves from the business.

The Act of 1874, as amended, authorizes out-and-out sales, like the water works sale, or mergers like that in the *Merwine* case and in the case at bar where the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company transferred all of their property rights and franchises to the Metropolitan Edison Company in exchange for stock so that the interests of the old companies were amalgamated and merged with those of the surviving corporation. The old companies not only ceased to do business, but by the very nature of the transfer ceased to exist. In so doing the Metropolitan Edison Company took the property of the transferor corporation *cum onere* (*Merwine* v. *Mt. Pocono Land Improvement Company* case, *supra*), although an action pending against the old companies would not abate.

Being a merger under the Pennsylvania law, the transfer of the assets of the absorbed corporations to the Metropolitan Edison Company was not void, having been accomplished in accordance with the statutory provisions of Section 23 of the Act of 1874,

as amended. There could be no occasion to file a bill in equity to discover assets, as in the case of a fraudulent conveyance, since there was no concealment requiring the discovery. The transaction was entirely open and above-board and the facts readily ascertainable by all parties in interest.

The Supreme Court of Pennsylvania has held that the remedy of creditors of a *merged* corporation is to follow the assets into the hands of the surviving corporation. Thus in *Berkovitz's Appeal,* 319 Pa. 397, at page 407, the Court said:

> "* * * we have also decided in other cases that creditors of one corporation may follow the property or assets of such corporation into a new corporation *where there has been a merger,* or, in cases of fraudulent transfer. See Halpern *v.* Grabosky, 296 Pa. 108, 111; Merwine *v.* Mt. Pocono, 304 Pa. 517, 522; Delphia Knitting Mills Co. *v.* Richards, 62 Pa. Superior Ct. 9, 12." (Italics added.)

As the court in the above case pointed out, where there is a merger the creditors of one corporation may follow the property or assets of that corporation into the new corporation. In this respect the remedy is the same as that afforded creditors in the case of a fraudulent transfer. Attention, however, is called to the fact that while the remedial procedure may be the same in the case of a merger as in the case of a fraudulent transfer, the basis for the remedy in one is not the same as the basis for the remedy in the other. A creditor in the case of a merger is given

certain remedies as a legal incident of the merger, namely, that the successor corporation is liable for the debts of its predecessor while in the case of a fraudulent transfer by way of sale or otherwise, a creditor is granted equitable relief. In the case of a merger there is no necessity of resorting to equitable principles.

In the case of *Merwine* v. *Mt. Pocono Land Improvement Company, supra,* the Court said that the plaintiff having secured judgment could *"levy* where defendant's assets liable for the judgment may be found." The direction of the Court to "levy" could only mean one thing—the issuance of a writ of *fieri facias* and the seizure by the Sheriff of the property owned by the Mt. Pocono Company and now in the hands of the Pennsylvania Power and Light Company. The Supreme Court of Pennsylvania made this perfectly clear in *Weinroth* v. *Homer B. and L. Association,* 310 Pa. 265, p. 270, where, in referring to the *Merwine* case it said: "The court there directed plaintiff, if he recovered judgment, to pursue the property of defendant in possession of the merged company." Since the transfer of the property of one corporation to another corporation under the provisions of the Act of 1874, as amended, is authorized by statute, the property upon its transfer is, in fact, the property of the transferee or surviving corporation and cannot either in law or in equity be considered the property of the old corporation. Therefore, to say that upon a merger a creditor of the transferor corporation can pursue the property for-

nerly owned by it into the hands of the merged company can only mean that the merged company acquires the property of a transferor corporation subject to all of its debts and liabilities.

There can be no doubt that under the Pennsylvania law when one corporation by merger succeeds to the assets of another, it likewise succeeds to all of the other's rights and is bound as well by all its obligations. That such liability exists was recently recognized by the Supreme Court of Pennsylvania in *Commonwealth* v. *Merchants National Bank of Allentown*, 323 Pa. 145, 185 A. 823,* where the Court said:

> "While there is general agreement in applying the rule of implied liability in cases of *merger* or *consolidation* or *purchase*, the courts have not always agreed on the reasons for doing so." (Italics added.)

As has already been pointed out, a merger under the Act of 1874, Section 23, as amended, has been considered by the Supreme Court of Pennsylvania as being practically the same as a consolidation under the Act of 1909.

The Act of 1909 (Title 15 Purdon's Statutes, Sections 421-425) contains the following provision:

> "Section 423. Effect of merger * * *
>
> "* * * Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited

*For a further discussion of this case see page 43, *infra*

in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it."

The effect of the decisions in the *Merwine* and other cases above mentioned is to make the law with respect to the rights of creditors of merged corporations identically the same as the statutory rights of creditors of constituent corporations in consolidations effected under the Act of 1909.

It is a general proposition that where a corporation is absorbed by another and transfers its assets in consideration for the shares of stock in the transferee corporation the latter is liable for the debts and liabilities of the former, regardless of whether the transaction takes the form of a strict merger or not. See 15 *Fletcher Cyclopedia Corporations* (Perm. Ed.) Section 7127, *15 A. L. R. 1112, 30 A. L. R. 558, 39 A. L. R. 143.* The Pennsylvania cases support this proposition.

Contrary to the opinion of the United States Circuit Court of Appeals for the Second Circuit rendered in the *General Gas & Electric Corp.* case, *supra,* the respondent submits that the law of Pennsylvania gives creditors of a merged or constituent corporation a plain, adequate and complete remedy at law against

the surviving or new corporation for the debts and obligations of the absorbed corporation. However, such a right is not a *sine qua non* of a technical merger or consolidation for the reason that it is generally held that if a creditor does not have an adequate remedy at law he may proceed in equity to enforce his rights against merged or constituent corporations. See Section 7170-7171 of *Fletchers Cyclopedia Corporations* (Perm. Ed. Vol. 15).

Whether or not the creditors of a merged or consolidated corporation have the right to enforce their claims at law or in equity is immaterial so long as the successor corporation remains liable for the same. The petitioner in his brief before the Circuit Court of Appeals (omitted here) naively suggested that liability would flow under circumstances in this case "under equitable principles and not by operation of law." Whether such liability be characterized as an assumption of liability by operation of law or upon the application of equitable principles is immaterial. It is not from what the procedure is called that the assumption of liability flows, but it is the result of the procedure.

Where, therefore, a Pennsylvania corporation merges with or absorbs another corporation, each having substantially the same stockholders, the transfer of the assets from the old corporation to the continuing corporation carries with it by *operation of law* the liability for the debts of the old corporation even though there is no contract or agreement

by the continuing corporation to assume such debts. The assumption by operation of law of such liability completely meets the test prescribed in the case of the *American Gas and Electric Company* v. *Commissioner*, 85 Fed. (2d) 527.

In the argument which has here been presented the respondent is sustained by the opinion of the Court below which said on page 810 of the Reports:

> "We are convinced that the transactions, by means of which the petitioner absorbed the subsidiaries here involved, partook of all of the essential elements of a merger (Chicago, S. F. & C. Ry. Co. *v.* Ashling, *supra*), and that the petitioner is entitled to the deduction claimed for 1928. *American Gas & Elec. Co.* v. *Comm.*, 2 Cir., 85 F. 2d 527; *New York Cent. R. Co.* v. *Commissioner*, 2 Cir., 79 F. 2d 247, certiorari denied 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465; *Western Maryland Ry. Co.* v. *Commissioner*, 4 Cir., 33 F. 2d 695; *American Gas & Elec. Co.* v. *U. S.*, 17 F. Supp. 151, Ct. Cl."

II.

The Transaction by Which the Metropolitan Edison Company Acquired the Assets of the Metropolitan Power Company and Assumed its Obligations was a De Facto Merger and the Former Company is Entitled to Deduct the Unamortized Bond Discount and Expense with Respect to the Latter's Bonds upon Their Redemption.

In its income tax return for 1927 the Metropolitan Edison Company deducted unamortized discount and

expense with respect to certain bonds of the Metropolitan Power Company which it had retired in that year. Particular attention must be given to the transaction by which the Metropolitan Edison Company purchased the assets and took over the liabilities of the Metropolitan Power Company since that transaction differed in certain respects from the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company.

As stated by the petitioner in his brief, the circumstances relating to the redemption of those bonds in general resemble those relative to the redemption in 1928 of bonds issued by other corporations whose assets the taxpayer acquired, except for the fact that the agreement by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not entered into pursuant to any Pennsylvania Statute. Therefore, in so far as the deduction with respect to the bonds of the Metropolitan Power Company was concerned, the provisions of Section 23 of the Act of 1874 as amended (Section 595, Title 15 of Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 73) are not involved.

It appears from the facts that the Metropolitan Power Company was formed originally to provide the parent company (the taxpayer) with additional

electrical energy, it being formed as a separate cor poration merely for the purposes of financing th construction of a power plant through a first mort gage (R. 32). Its entire output was contracted fo by the respondent for a consideration which wa sufficient to enable the Power Company to earn a gross revenue at least sufficient to meet all costs o operation and other charges other than for capita purposes including maintenance, depreciation, taxes and interest on indebtedness (R. 32). Substantially all of the stock of the Power Company was owned by the respondent and in the method of operation of its electric generating plant the Power Company was simply a department of the respondent (R. 32). Immediately upon the organization of the Power Company the respondent purchased and guaranteed and sold to the public all of the bonds issued by the Power Company; purchased all of the stock and loaned to the Power Company on an open account approximately $3,000,000 and except for the $3,250,000 of bonds, the respondent was practically the sole investor and creditor (R. 32).

The bonds were originally issued at 90 to the respondent which immediately endorsed them and guaranteed them as to principal and interest and sold them to the public at the same price (R. 32).

In February, 1927, the Power Company transferred to the respondent all of its assets and liabilities as they stood upon its books and a deficit in operations was charged against the surplus of the respondent

(R. 32). The respondent surrendered the capital stock of the Metropolitan Power Company which it owned for cancellation and the Power Company became inactive about February 28, 1927, although it was not formally dissolved until January 28, 1928 (R. 32).

At the time of the transfer in February, 1927, the respondent assumed the $3,250,000 liability under the Power Company's bonds which had been guaranteed by respondent at the time of issuance. The respondent cancelled the debt of the Power Company to it in the amount of approximately $3,000,000 (R. 32).

The respondent redeemed the bonds at a premium during the latter part of 1927, at which time the unamortized bond discount and expense amounted to $308,097.90 (R. 32-33).

It was admitted before the Board (R. 39-40) and in the Court below (R. 54) that the transfer of the assets from the Power Company to the Metropolitan Edison Company did not take place pursuant to any Pennsylvania Statute. Even though there was no statutory merger involved, it is contended, however, that the transfer had all of the elements essential to a merger in that the Power Company for all practical purposes ceased to exist and the Metropolitan Edison Company was liable for its debts and obligations. In short, there was a *de facto* merger entitling the taxpayer to the deductions claimed. The Court below

agreed with the taxpayer's position on this point, and said (R. 54):

> "The analysis of this transaction shows: (1) that the Power Company transferred all of its assets to the petitioner; (2) that the petitioner was an existing corporation and continued to exist; (3) that the Power Company, though it did not automatically cease to exist upon the completion of the transaction, did discontinue all operations and was left without stockholders or property of any sort, and (4) that the petitioner, both by contract and operation of law, became liable for the debts of the Power Company. 14 C. J. 970; 15 Fletcher Cyclopedia Corporations, section 7127; *In re* Harr, *supra; In re* Buist's Estate, *supra;* Commonwealth *v.* Merchants Nt. Bank of Allentown, *supra.*
>
> "The only difference between the above procedure and that followed by the petitioner under the 'short form merger statute' with reference to the 1928 deduction was that the Power Company continued to exist nominally, while the Cumberland, York-Haven, Hanover and Pennsylvania Edison Companies automatically under the statute ceased to exist except as noted above. This was a mere technical, and not a practical or substantial difference, and should not determine the rights of the parties. Moreover, the transfer by the Power Company of all of its assets and cancellation of all of its stock effected its *de facto* dissolution. (14 (a) C. J. 1117; Lauman *v.* Lebanon Valley R. Co., 30 Pa. 42; Reynolds *v.* Cridge, 1 Dist. 693; 11 Pa. C. C.

306; Commonwealth *v.* Altoona & P. C. R. Co., 32 Pa. C. C. 449; Skirvin Operating Co. *v.* Southwestern Electric Co., 174 Pac. 1069, 15 A. L. R. 1104, 1110), and its formal dissolution in January 1928 was only a declaration of that fact. 14 (a) C. J. 1118."

The courts of Pennsylvania recognize *de facto* consolidations or mergers where the essential elements of such transactions are present, even though not carried out under statutory provisions. The Supreme Court of Pennsylvania recently had such a question before it in the case of *Commonwealth* v. *Merchants National Bank of Allentown*, 323 Pa. 145; 185 A. 823. The facts were that a trust company and a national bank entered into an agreement consolidating their assets without following the statutory procedure authorizing such consolidations. Subsequently, the consolidated bank was sued upon a bond which had been formerly given by the trust company. In the action on the bond the defendant consolidated bank denied liability on the bond. The Supreme Court of Pennsylvania held that there was a *de facto* consolidation and that the consolidated bank assumed the liability of the trust company on the bond. The Court said in its opinion at page 152:

"The consolidating procedure, in its Pennsylvania aspect, was irregular but certain consequences nevertheless resulted. The parties to the consolidation, when confronted with an obligation like that now involved, must meet it as if

they had complied with the statutes which would have enabled them to consolidate. If, for the purposes of this suit, we accept its contention that the consolidation was not "legal" in the respect indicated, defendant will not be permitted to deny its effect in fact: *Cochran* v. *Arnold*, 58 Pa. 399, 405; *Hamilton* v. *Clarion M. & P. R. Co.*, 144 Pa. 34, 23 A. 53; *Tibby Bros. Glass Co.* v. *P. R. R. Co.*, 219 Pa. 430, 68 A. 975.

* * * * * * *

"While there is general agreement in applying the rule of implied liability in cases of merger or consolidation or purchase the courts have not always agreed on the reasons for doing so. (Foot Note.) This appeal does not require discussion of these reasons. We cannot adopt a rule that would permit the repudiation of lawful obligations by the failure of two corporations to observe required procedural steps in uniting their property under one charter. It is sufficient to say that the declared policy of the law of this Commonwealth governing consolidation *de jure* requires similar assumption of liabilities by consolidations in fact."

It will be seen from the above case that in Pennsylvania *de facto* consolidations are recognized and carry with them all of the legal consequences and effects of a statutory consolidation even to the extent of imposing upon the consolidated company the liabilities of the constituent companies just as though the consolidation had been carried out under a statute. If there can be a *de facto* consolidation there can of

course, be a *de facto* merger, and it is contended that was the substantial effect of the transaction between the Metropolitan Power Company and the Metropolitan Edison Company under Pennsylvania law.

The Power Company never really had any substantial existence independent of the Metropolitan Edison Company. To all intents and purposes the Power Company was really an arm or branch of the parent company and had been called into existence merely for the purpose of negotiating a mortgage on a new electrical generating plant needed by the Metropolitan Edison Company. There was never any necessity of following any statutory procedure to effect the transfer of the assets and liabilities of the Power Company to the Metropolitan Edison Company for the reason that the Power Company held no public franchises. While it is true that the transaction took the form of a sale, no consideration passed since the Metropolitan Edison Company was the sole stockholder of the Power Company and the transaction amounted to nothing more than a merger of the assets and liabilities of the Power Company into the parent company. As has been pointed out heretofore, the fact that a transaction takes the form of a sale does not prevent it from being a merger. It is the result accomplished, not the means, which determines the nature of such a transaction.

Not only did the Power Company for all practical purposes cease to exist after its assets had been transferred to the parent company, but its obligations as

well became those of the parent company. As the Supreme Court of Pennsylvania said in the recent case of *Lansdowne Bank & Trust Company (In re Harr)*, 323 Pa. 380, 186 A. 120, at page 384:

> "The well settled principle applies that where one corporation purchases the business and assets of another, it succeeds to all the other's rights and is bound as well by all its obligations: *Maxler* v. *Freeport Bank et al.*, 275 Pa. 510; *Buist's Estate*, 297 Pa. 537."

Since the effect of the transaction between the Power Company and the Metropolitan Edison Company constituted a *de facto* merger, the latter company was entitled to deduct the unamortized bond discount and expense remaining at the time that the bonds of the Power Company were retired prior to maturity.

III.

Regardless of the Nature of the Transactions in This Case the Metropolitan Edison Company Actually Sustained a Loss on Account of Unamortized Bond Discount and Expense Which it is Entitled to Deduct.

Since the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company were merged with the Metropolitan Edison Company under the Act of 1874, as amended, and since the absorption of the Metropolitan Power Company by the Metropolitan Edison Company was a *de facto* merger, respondent contends, for the reasons

hereinabove set forth, that the deductions claimed for the unamortized debt discount and expense at the time of the redemption of the bonds of the affiliates were properly allowable under the decisions in *American Gas & Elec. Co.* v. *Commissioner,* 85 F. 2d 527 (C. C. A. 2); *New York Central R. Co.* v. *Commissioner,* 79 F. 2d 247 (C. C. A. 2); certiorari denied 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465; *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. 2d 695 (C. C. A. 4).

Respondent further contends, however, that regardless of the nature of the transactions involved the Metropolitan Edison Company was in any event entitled to the deductions allowed in accordance with the provisions of the Revenue Acts of 1926 and 1928, which, like previous Revenue Statutes, provide that in computing net income, corporations shall be entitled to deduct all the ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business, all interest paid or accrued within the taxable year on indebtedness, and all losses sustained during the taxable year and not compensated for by insurance or otherwise, see Section 234 (a) (1) (2) and (4) of the Revenue Act of 1926 and Section 23 (a), (b) and (f) of the Revenue Act of 1928 (Appendix A, *infra,* p. 69).

It has been held in a number of cases that as a general rule deductions are allowable only to the taxpayer who incurred the expense or loss (*Planters Oil Co.* v. *Hopkins,* 286 U. S. 332; *Welch* v. *Helver-*

ing, 290 U. S. 111; *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Pennsylvania Co.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3rd), and that therefore a corporation which purchases all of the assets of another cannot take a deduction for the losses sustained by the seller corporation. This general principle has been applied by the courts in holding that deductions for amortization of bond discount and expense are not in general allowable to a corporation which by purchase and sale for consideration has taken over the assets of the corporation which issued the bonds and assumed their liabilities. See *American Gas & Elec. Co.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A. 2nd); *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2nd), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th); *Turner-Farber-Love Co.* v. *Helvering,* 68 F. (2d) 416 (App. D. C.); *New York, C. & St. L. R. Co.* v. *Burnet,* 64 F. (2d) 152 (App. D. C.); *American Gas & Electric Co.* v. *United States,* 17 F. Supp. 151 (C. Cls.).

The theory on which the amortization of bond discount and expense is deductible is that the discount and expense reduce by their amount the capital realized by the company issuing the bonds, and, while they come out of the pocket of the taxpayer corporation only upon the payment of the bonds at maturity, the loss may properly be amortized over the life of the bonds. Therefore, in the case of *Helvering* v.

Union Pacific Railroad Co., 293 U. S. 282, this Court said (pp. 286-287):

> "Both commissions and discount, as the Government concedes, are factors in arriving at the actual amount of interest paid for the use of capital procured by a bond issue. The difference between the capital realized by the issue and par value, which is to be paid at maturity, must be added to the aggregate coupon payments in order to arrive at the total interest paid. Both discount and commissions are included in this difference. *If the difference be viewed as a loss resulting from the funding operation, it is one which is realized only upon the payment of the bonds at maturity.*
>
> * * * * * * *
>
> * * * We think that the revenue acts, as they have been interpreted by this Court and the treasury regulations upon this and related subjects, require that this difference between receipts and disbursements of the taxpayer should, in some form, enter into the computation of his taxable income. It is a loss to the taxpayer, definite as to its date and amount, and represents a part of the cost of the borrowed capital during each year of the life of the bond issue. Cf. *United States* v. *Anderson, supra.* At least where the taxpayer's books are kept upon the accrual basis, its final disbursement may be anticipated by amortization and the amortized amount deducted annually from his gross income." (Italics added.)

It has therefore been held that when a corporation retires bonds issued at a discount, it is then entitled

to deduct the portion of the bond discount and expense which has not previously been deducted. *Gt. W. Power Co.* v. *Commissioner,* 297 U. S. 543; *San Joaquin Light & Power Corp.* v. *McLaughlin,* 65 F. (2d) 677 (C. C. A. 9th); *Helvering* v. *California Oregon Power Co.,* 75 F. (2d) 644 (App. D. C.); *Helvering* v. *Union Public Service Co.,* 75 F. (2d) 723 (C. C. A. 8th); *Helvering* v. *Central States Electric Corp.,* 76 F. (2d) 1011 (C. C. A. 2d).

The reasoning of the cases and the basis of the rule allowing a corporation which redeems bonds prior to maturity to deduct unamortized bond discount and expense is, of course, that the corporation so redeeming the bonds actually sustains a loss for which it has not been compensated and that therefore under the express terms of the Revenue Statutes such loss is deductible. The courts have, however, very properly held that where the corporation which redeems the bonds has purchased the assets and liabilities of the corporation issuing the bonds, unamortized bond discount and expense remaining at the time of redemption cannot be deducted. *Planters Oil Co.* v. *Hopkins,* 286 U. S. 332; *Welch* v. *Helvering,* 290 U. S. 111; *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Pennsylvania Co.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3rd). There is a very good reason for the refusal of the courts to allow a purchasing corporation to take such deductions, namely, that in purchasing the assets of a corporation issuing bonds at a discount

e prospective loss to be sustained in the event that e bonds should be redeemed by the purchasing cor- ration prior to maturity is adjusted or compensated r in the purchase price paid for the assets of the suing corporation, and to allow the purchasing cor- ration to take such deduction upon redemption of e bonds would result in allowing the purchasing rporation the benefit of a loss which it never tually sustained. Looking at it from another point f view, to allow such deduction to a purchasing rporation would be allowing one corporation to rry over a loss which was really sustained by a redecessor.

The courts have, however, as has been pointed out nsistently, allowed a merged corporation to take ch deduction in redeeming the bonds of a pre- cessor corporation prior to maturity. The basic ason for such an allowance is that in the case of a erger the loss is actually sustained by the corpora- on redeeming the bonds and such loss was not sus- ined by the predecessor corporation nor in any ay compensated for at the time of the merger.

While the court in the case of *American Gas & lec. Corp.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A.) recognized the rule that a merged corporation ay deduct the unamortized bond discount and ex- nse remaining at the time that it redeems bonds sued by its predecessor, limited that rule to strict atutory mergers. The petitioner in this case is kewise attempting to limit the rule with respect to

the deduction of unamortized bond discount and expense. The respondent, however, contends that in so limiting the application of the rule, the Court, in the *American Gas & Elec. Co.* case, *supra,* and the petitioner here, do violence to the legislative intent that where a loss is sustained by a corporate taxpayer and is not compensated for, the same is deductible.

In each instance the transaction by which the Metropolitan Edison Company absorbed its affiliated companies resulted in a purely technical change in the relation between it and those companies. The change was a pure formality involving no change in substance. / No price was paid to the absorbed companies which could or did reflect an allowance for the unamortized bond discount and expense. The absorbed companies never sustained and never took any loss on account of the unamortized bond discount and expense since such loss could only rise when the bonds were retired prior to maturity by the Metropolitan Edison Company. Unless it is entitled to take the loss, no one obtained the benefit thereof contrary to the express intention of Congress that a corporation which sustains a loss which has not been compensated for shall be entitled to deduct the same in computing its net taxable income.

In support of its contention the respondent urges upon this Court the rationale of the decisions in the case of *Western Maryland Rwy. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4) and *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2).

In *Western Maryland Railway Co.* v. *Commissioner*, 33 Fed. (2d) 695 (C. C. A. 4), the question was whether the Western Maryland Railway Co. was entitled to amortize and deduct discount on bonds issued by its predecessor which consolidated with seven subsidiaries, all of whose stock it owned and whose property it operated as its own. The Interstate Commerce Commission required that the unamortized discount be carried on the balance sheet of the consolidating company and amortized over the remaining life of the bonds. The Board of Tax Appeals denied the deduction and the Railway Company appealed.

In reversing the decision of the Board the Court said:

> "We come then to the second question in the case: Has the right to deduct the amortized portion of the discount been lost by reason of the reorganization of the corporation that sold the bonds and the taking over of its assets and liabilities by the consolidated company? We think not. In the first place, it is perfectly clear that, although there has been a reorganization and although the consolidated corporation is a distinct legal entity from those whose places it has taken, nevertheless in all of its essential relationships, it occupies exactly the same position which they occupied. Its management is the same, its assets are the same, its stockholders are the same, and its obligations are the same, except that the floating indebtedness of the old corporation has been taken up by the first preferred stock of the new, a change which might have been effected by the

old corporation without reorganization, and which manifestly can have no bearing upon the matter of bond discount. In other words, the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied. It has received no consideration for its agreement to pay them except the assets of the old corporation which have been transferred to it. It has the same property as the old corporation, owes the same bonded debt, and is bound to pay it in the same way. The Interstate Commerce Commission requires that the unextinguished discount be carried on the balance sheet of the company and that same be amortized by charge against income for the remaining life of the bonds, just as though no reorganization had taken place; and, if the deduction is to be allowed as a basis for rate making and for determining the rights of the government under the recapture clause of the Transportation Act, there is no reason why it should not be allowed in determining the basis of taxation also. *After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.'* Chicago, Milwaukee & St. Paul R. Co. *v.* Minneapolis Civic Assn., 247 U. S.

490, 501, 38 S. Ct. 553, 557 (62 L. Ed. 1229); Southern Pac. Co. *v.* Lowe, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142; Gulf Oil Corporation *v.* Lewellyn, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133. *"The rule just stated is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer.* It is instructive to note the many tax cases decided in recent years in which the courts have not hesitated to ignore corporate forms, and to decide the questions involved in the light of what the parties have actually done, rather than on the basis of the forms in which they have clothed their transactions. See Weiss *v.* Stearn, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520; U. S. *v.* Phellis, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; Eisner *v.* Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Gulf Oil Corp. *v.* Lewellyn, *supra;* Alpha Portland Cement Co. *v.* U. S. (C. C. A. 3d), 261 F. 339; Appeals of A. J. Siegel, 4 B. T. A. 186; Appeal of H. E. Brubaker, 4 B. T. A. 1171. *We think, therefore, that as the new corporation, while technically a distinct legal entity, is to all practical intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to, if the reorganization had not taken place."* (Italics added.)

It is important to note from the above statement that, although there was a technical legal consolidation in that case, the Court did not base its opinion upon that fact, but upon the fact that the consolidation effected a change in form only and that although the consolidating corporation was technically a different corporation from the issuing corporation, it was "to all practical intents and purposes a mere continuance of the old" and "entitled to the same deduction on account of bond discount that the old corporation would have been entitled to." Indeed the Court continued:

> "In the second place, we think that, irrespective of the practical identity of the old and new corporations, petitioner is entitled to the deductions claimed because of having taken over the assets and assumed the liabilities of the old corporation which was unquestionably entitled to it. Among the liabilities of the old corporation as shown by its books was the bond issue; and among its assets was the amount set up as bond discount, against which was charged each year an amortized portion thereof. In taking over the liabilities and assets, the new corporation took the place of the old as to both of these items. As has been said, bond discount is really deferred interest payable at the maturity of the bonds. When, therefore, the new corporation assumed the obligations of the old, its agreement to pay the bonds at maturity embraced necessarily the agreement to pay this deferred interest, which is included in the face of the bonds. As the

new corporation is bound to pay this, there is no reason why it should not amortize it in the same way as the old corporation."

The decision of the Court in the Western Maryland case was approved by the Circuit Court of Appeals for the Second Circuit in *New York Central Railroad Co.* v. *Commissioner,* 79 Fed. (2d) 247, in which the Court said:

"In Western Maryland R. Co. *v.* Commissioner, 33 F. (2d) 695 (C. C. A. 4), it was held that a consolidated corporation steps into the place of the constituent corporations and is entitled to deduct amortized discount on bonds issued by them. We think this decision is sound and should be followed in the case at bar. The consolidated corporation does not succeed to the rights and liabilities of the constituent companies as a purchaser but as a successor by operation of law. See Cortland Specialty Co. *v.* Commissioner, 60 F. (2d) 937, 939 (C. C. A. 2); Commissioner *v.* Oswego Falls Corp., 71 F. (2d) 673, 676 (C. C. A. 2). The assets of the consolidated corporation have the same cost basis as they had when held by the old companies and are subject to the lien of the bond issues. Hence the consolidated corporation will suffer a loss when it pays the bonds at par, and the regulations as to spreading this loss over the life of the bonds should apply. They do not in terms confine discount deductions to the issuing corporation, and should not be construed to do so. If the new corporation cannot take the deduction, no one can, for the old companies sustained no loss

when the consolidation was affected. As already stated, the subject of amortization is the difference between the cash realized on the bonds and their par value. This difference the consolidated corporation will pay when the bonds mature, and this expenditure it should be allowed to anticipate by yearly amortization during the life of the bonds in order more clearly to reflect its income.

"* * * * * * *

"The petitioner also claims to be entitled to deduct in each of the taxable years the amount of $29,518.97 discount on bonds of predecessor companies which were merged with the petitioner. The principles above discussed as applicable in case of consolidation are equally applicable to merger. * * *." (Page 250 of opinion.)

Petitioner takes the position that the Metropolitan Edison Company, in assuming the bonds of its affiliates, agreed to pay the full face value of the bonds in consideration of the assets being transferred to it, and that, for this reason, the company received full consideration for its promise to pay the bonds and has suffered no discount.

This argument was effectively answered by the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Co.* v. *Commissioner,* 33 F. (2d) 695, where the Court said at page 698:

"It is argued, however, that the new corporation has agreed to pay the full face of the bonds in consideration of the assets transferred to it.

and that, for this reason, it has received full consideration for them and has suffered no discount. But this by no means follows. The fact that bonds have been sold at a discount presupposes that the interest rate which they carry is less than the prevailing rate at the time of sale; and it is but fair to assume that this has been taken into account in the price paid or the terms agreed upon for the transfer of the corporate assets. The matter takes care of itself in the case of a reorganization such as this; for it is manifest that, as the discount was mirrored in the affairs of the old corporation by the fact that its actual assets were that much less than they would have been had the discount not been enacted, it is mirrored in exactly the same way when the assets pass into the hands of the reorganization. As a man cannot lift himself by his own bootstraps, so a corporation cannot, by a mere process of reorganization, increase its actual assets or wipe out the fact that it is bound to pay bond discount which is in reality deferred interest."

The petitioner takes the same position in this case as he did in the case of *New York Central R. Co.* v. *Commissioner*, 73 F. (2d) 247, to the effect that deductions for losses, being personal to the taxpayer who actually sustained them, only the corporation actually issuing the bonds may deduct unamortized debt discount and expense. This contention was rejected and effectively answered by the court in the *New York Central R. Co.* case, *supra*, in its opinion on page 249 of the Reports, as follows:

"The Commissioner argues that allowable deductions are personal to the taxpayer and cannot be transferred to or used by another. But the cases which announce this doctrine deal with losses sustained by a predecessor and sought to be deducted by a successor. New Colonial Ice Co. *v.* Helvering, 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348; Brandon Corp. *v.* Commissioner, 71 F. (2d) 762 (C. C. A. 4); May Oil Burner Corp. *v.* Commissioner, 71 F. (2d) 644 (C. C. A. 4); Cem Securities Corp. *v.* Commissioner, 72 F. (2d) 295 (C. C. A. 4); Athol Mfg. Co. *v.* Commissioner, 54 F. (2d) 230 (C. C. A. 1). In the case at bar, no loss was sustained by the issuing corporations in selling their bonds at a discount; the loss will be sustained by the consolidated corporation when the bonds mature and are paid. Hence the deductions here in question are by way of anticipation of the taxpayer's own loss and should have been allowed."

The Circuit Court of Appeals, in the case of *General Gas & Elec. Corp., supra,* in sustaining the position of the petitioner based its decision upon the theory that the deduction for unamortized debt discount and expense on bonds of a predecessor company may be allowed only where the predecessor company was technically merged into the company actually sustaining the loss through payment of the bonds prior to maturity. This argument was apparently based upon the prior decision of the Second Circuit Court of Appeals in *American Gas & Electric Company* v. *Commissioner,* 85 Fed. (2d)

527. We respectfully submit that the decision of the majority of the Court in the *American Gas* case was erroneous and that the correct principle was laid down in the dissenting opinion of Judge Learned Hand. In that opinion, Judge Hand states:

> "If a company keeps its books on an accrual basis and issues bonds at less than par, the discount is immediately incurred, whether one regards it as a loss or an expense. If the books are on a cash basis, the discount is not paid until the bonds are paid. Thus, in either case there is no legal warrant for spreading the deduction over the life of the bonds; the practice which has grown up and is of undoubted validity, is based upon a fiction, following the accountant's device for preparing to meet the burden of paying the discount all at once. Unless this fiction is extended to cover a buyer in 'reorganization' it will be the means of preventing the deduction of a part of what at some time or other is an undoubted loss or expense. The buyer is not a party to the original loan and cannot claim any deduction because of it; it merely buys the assets and pays for them in cash and by a promise to pay the face of the bonds. It is true that that promise includes the discount, but the cash payment presumably is less by that amount, if the bonds bear interest. Certainly the buyer has not suffered any loss, or paid any expense. Nor will any deduction because of it appear in estimating the buyer's gain or loss, if it sells the assets in whole or in part. True, the buyer's 'basis' is the seller's 'basis,' but if the seller had sold the assets, its 'basis' would not include the discount.

> It would be the cost of the assets sold; that is, the amount borrowed so far as the proceeds of the bonds had been used to buy them. Therefore, all deduction for the unamortized discount disappears from the computation of the taxes of either buyer or seller, unless the buyer is allowed to complete the amortization deductions. A legal fiction is a good contrivance only if it effects a just result, but there is no excuse for it otherwise; this one must be carried out consistently in order to avoid injustice. There may be difficulties when the books are kept on a cash basis, but when as here they are not, it seems to me that the deductions of which the seller is deprived should enure to the buyer rather than be denied in toto."

We further submit that any rule which recognizes the fiction of amortization, and yet refuses to extend the fiction to its logical result, but rather restricts it in such a way as to deprive a taxpayer of a valid deduction for an actual loss, is based upon the technicalities of form, and neglects the fundamental reasoning expressed in the foregoing dissenting opinion, and also in the opinion of the Circuit Court of Appeals for the Fourth Circuit in the *Western Maryland Railway Company case, supra,* as well as in the opinion of the Circuit Court of Appeals for the Second Circuit itself, in the *New York Central Railway Company case, supra.* The true principle, we believe, should be based upon a judicial recognition of the fact that the payment of the unamortized discount is actually made, and the loss is actually sustained, by the successor

company in all cases where the transfer does not involve an arms-length sale for an independent consideration. If this principle be recognized, the proper rule of law would be that unamortized debt discount and expense, representing either additional interest or loss, should always be allowed to the corporation which actually pays it, except in cases where the circumstances show a reasonable probability that the amount of the additional interest or loss has already been compensated for in one form or another. This rule was clearly recognized by the Court of Claims in *American Gas & Electric Company* v. *United States* (17 F. Sup. 151), wherein it stated:

> "* * * The Securities Corporation acquired the assets of the Virginia Company by the payment of a definite consideration, and we think it is a fair presumption that the price so paid was adjusted to meet the fact that the corporation would have to pay the bonds in full."

In the instant case this situation does not obtain for the reason that no price was paid to make adjustment for the fact that the Metropolitan Edison Company would have to pay the bonds in full. Since there was no purchase price paid by way of consideration for the transfers here involved, it cannot be said that they constituted "sales" as distinguished from "mergers." The Metropolitan Edison Company merely surrendered the stock which it owned in the subsidiary companies in exchange for the assets of those companies. Under the circumstances in this

case no consideration was fixed in relation to the assets transferred nor was there taken into account the additional interest or loss represented by the unamortized discount and expense on the bonds of the constituent companies.

If in this case consideration had been paid, as in the case of an ordinary sale between corporations, the price so paid for the assets would have been diminished so as to reflect the amount of unamortized bond discount and expense, a purely fictitious asset or balancing item on the seller's balance sheet. In such case the loss would have been already "compensated for" within the meaning of the Revenue Acts, and, therefore, would not be deductible. Here, however, as has been pointed out, the contrary situation is evident.

Therefore, since it is impossible in the present case to infer that the price paid for the assets received by the Metropolitan Edison Company was adjusted to meet the fact that the company would have to pay the bonds in full, there are no circumstances which require or permit the disallowance of a deduction for additional interest or loss actually paid or sustained by that company, and for which it received no compensation.

It cannot be said either that by claiming the deductions the Metropolitan Edison Company is carrying over a loss sustained by a predecessor corporation such as in the case of *The Pennsylvania Company, etc.* v. *Commissioner,* 75 F. (2d) 719, and similar cases, or that the company is claiming a deduction

for a loss which has already been compensated for by being reflected in the purchase price of the assets of the old companies, as in *American Gas & Elec. Co. v. Commissioner,* 85 F. (2d) 527.

In a foot note to page 47 of his brief, the petitioner calls attention to the fact that the Board of Tax Appeals allowed the Metropolitan Edison Company to deduct the premium paid upon the bonds at maturity, upon the ground that that was an expense incurred for its own benefit (R. 37-39). The petitioner contends, however, that the same reasoning does not apply to the unamortized bond discount and expense. It is submitted on behalf of the respondent that there is no logical reason for making a distinction between a loss on account of preimums paid at the time that bonds are redeemed prior to maturity and a loss for unamortized bond discount and expense remaining at the time the bonds are redeemed in a case such as this where both the premium and the unamortized bond discount and expense represent an actual loss to the taxpayer for which it has not been compensated.

In presenting the argument that the Metropolitan Edison Company is not entitled to deduct the loss sustained on account of unamortized bond discount and expense, the petitioner states on page 38 of his brief that:

> "The regulations do not provide that a successor corporation shall be permitted to deduct amortization of bond discount and expense with respect to bonds issued by its predecessor. See

Article 68 of Regulations 74 (Appendix A, *infra*, p. 58). They grant the deduction in terms only to the corporation issuing the bonds."

It is submitted that Article 68 (3) (b) of Regulations 74 (Appendix A, *infra*, p. 70), does not limit the deduction for unamortized bond discount and expense to the corporation issuing the bonds. If, however, the Regulations are to be so interpreted and construed then they are not in accordance with the provisions of the Revenue Acts of 1926 and 1928 which, as have been pointed out, allow a corporation to deduct a loss which it has actually sustained and for which it has not been compensated.

CONCLUSION.

Since the transactions by which the Metropolitan Edison Company took over the assets and assumed the liabilities of Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, the Pennsylvania Edison Company and the Metropolitan Power Company were, under Pennsylvania law, either statutory or *de facto* mergers, the Respondent was entitled to the deductions claimed on account of unamortized bond discount and expense.

In any event the deductions should be allowed since the Revenue Acts of 1926 and 1928 specifically provide that corporations in computing their net income

may deduct losses for which they have not been compensated. No loss was sustained in this case by anyone either directly or indirectly on account of the unamortized bond discount and expense until the bonds were redeemed prior to maturity by the Metropolitan Edison Company, which then sustained the loss by reason of the fact that the corporations issuing the bonds had merged into the Metropolitan Edison Company which became the successor to all of their assets and liabilities. To deny the loss to the taxpayer in this case defeats the legislative intent.

It is therefore contended that the decision of the Court below should be affirmed.

Respectfully submitted,

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APPENDIX A.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise."

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. *Deductions from Gross Income.*—In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a

reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Treasury Regulations 74:

"ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchasing price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires

any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of dis-

count already deducted, the excess of the purcha price over the issuing price plus any amount of di count already deducted (or over the face value minu any amount of discount not yet deducted) is a d ductible expense for the taxable year. (*c*) If, ho ever, the corporation purchases and retires any such bonds at a price less than the issuing price pl any amount of discount already deducted, the exce of the issuing price plus any amount of discou already deducted (or of the face value minus a amount of discount not yet deducted) over the pu chase price is gain or income for the taxable year.

ART. 176. *Sale of capital stock, bonds, and capit assets.*—A corporation sustains no deductible loss fro the sale of its capital stock. (See article 66.) If sells its bonds at a discount, the amount of su discount is treated in the same way as interest pa and if it retires its bonds at a price in excess of t issuing price, such excess may usually be deducted expense. (See article 68.) Any loss sustained by corporation upon the sale of its capital assets, co puted as provided in sections 111-113 and articles 5 604, subject to the limitation provided in section 1 as to the purchase and sale of stock or securities, deductible."

Treasury Regulations 69:

[Inasmuch as Articles 545 and 563 of thes Reg lations are identical in all material respects wi Articles 68 and 176 of Regulation 74 above quote they are not set forth separately.]

APPENDIX B.

Section 23 of the Pennsylvania General Corporation Act of 1874, as amended.

(Purdon's Penna. Statutes, Annotated (Permanent Ed.), Title 15, Section 595.)

"SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property.*—Any corporation created under the provisions of this act, and any corporation of the classes named in the second section thereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first, and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: *Provided,* That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Com-

monwealth, a certificate from the Auditor Gener of the Commonwealth, setting forth that all repor required by the Auditor General of the Commo wealth have been duly filed to the date of the propose sale, assignment, disposition, and conveyance; an that all taxes due the Commonwealth of Pennsylvani have been paid up to and including such date. * * (1874, April 29, P. L. 73, Sec. 23; 1876, April 1 P. L. 30, Sec. 5; 1915, June 2, P. L. 724, Sec. 1 1931, June 12, P. L. 561, Sec. 1)."

Purdon's Pennsylvania Statutes, Annotated (Per manent Edition), Title 15 (Act of 1909):

"SEC. 421. *Merger authorized; exceptions; exclusiv franchise not extended; merger subject to act o 1907.*—It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor.*—

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First.—The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. * * *"